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**Ideology and National Competitiveness
George C. Lodge**

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Ideology and National Competitiveness

George C. Lodge

Since 1963, Professor Lodge has been a member of the faculty of the Harvard Graduate School of Business Administration, where he teaches Business, Government, and the International Economy in the Advanced Management Program and Human Resource Management in the school's MBA Program. In prior positions, he was Director of Information of the U.S. Department of Labor and Assistant Secretary of Labor for International Affairs, as well as U.S. Delegate to the International Labor Organization (ILO) and Chairman of the ILO's Governing Body. He is a member of the Board of Trustees of the Carnegie Endowment for International Peace, of the World Peace Foundation, and of the Robert F. Kennedy Memorial and a member of the Council on Foreign Relations and the Newcomen Society of North America. His numerous books and articles include Engines of Change: United States Interests and Revolution in Latin America (1970), The New American Ideology (1975), and Ideology and National Competitiveness: An Analysis of Nine Countries (editor, with Ezra F. Vogel, 1987).

Oettinger: You've seen George Lodge's biography, so I won't go much further in introduction on the personal side. A word about background. The reading for today included both your book with Ezra Vogel* and I also suggested that folks look at Al Chandler's *Visible Hand*.** I think there are some connections, at least in my mind. Now chatting with Mr. Lodge before the class, he indicated some of his intentions, and when I was asked about preference for emphasis on substance versus process, I indicated that in case of doubt to move a little more toward the process side on the grounds that our interest here was in techniques of conforming about the context of the world in intelligence, and reacting in terms of command and control, and that the substance, in the particular terms of his interests, was delightful in making things concrete

*Lodge, George C. and Ezra F. Vogel, *Ideology and National Competitiveness: An Analysis of Nine Countries*. Boston: Harvard Business School Press, 1987.

**Chandler, Alfred D., Jr., *The Visible Hand: The Managerial Revolution in American Business*. Cambridge: Harvard University Press, 1977.

and meaningful, but when in doubt, adjust the mix toward process since the substantive interests of the group are all over the place and not necessarily in the direction of competitiveness. I think that that's adequate, by way of common ground and with that I'll turn it over to you.

Lodge: What Professor Oettinger asked me to do was to talk a little bit about techniques for understanding the business environment and reacting to it, adjusting to it, and managing in it. That's what I teach at the Business School, so it's a pleasure to put two concepts before you that have been useful to me.

The first concept is ideology, which you have a reading on, strictly defined and rigorously used, to understand changes occurring within a community, and to compare one community with another community. One of the virtues of ideology is also that it forces analysts to inspect their assumptions. That is one of the two prerequisites to effective environmental analysis: the capacity to know the blinders that you wear. Knowing them, you may find that

they are acceptable, useful, and appropriate, but you may find that they are not. Ideology is a good way of checking on the blinders.

The second concept is country analysis — the analysis of a country's national strategy, which I'll talk about just for a minute here, so in case you want to get into that, we can. This gets to the second prerequisite for effective environmental analysis, which is the capacity to see an environment as a system, to see the relationships among the pieces: the political, the social, the economic, the cultural, the physical, the spiritual, domestic, and international.

Now we all know intuitively that that's a good idea, that everything's related to everything else. It is difficult to act on for several reasons. The first is really academic. We have all been trained, expensively and diligently, in academic institutions which spend a lot of time teaching us how to divide the environment up, either as economists, or political scientists, or government specialists, or whatever. That has its uses. I don't mean to say it doesn't, but it is not much help when it comes to seeing the environment as a system. We, at the Business School, have devised a procedure which is integrated in academic terms, which we think is useful in looking at environments going through space and time. Let me talk about that for a minute, and then I'll come back to ideology, and then we can do whatever you like.

Let me describe what I mean by country analysis (figure 1). Let's say you want to understand where Japan is today, or where the United States is. Why the United States is in the condition that it is, or why Japan is, or any other country. How do you do that? The way you do it here is, you look at the performance of the country over time, and you use economic measures to measure that performance: national income accounting, balance of payments and so forth. Then you look at how different components of that performance have changed, or are changing. For example, if you look at Japan you will see that consumption has been relatively flat; investment, the highest rates of investment in the world; government expenditures, relatively flat; and exports, the highest rates in the world. So you get an immediate picture of this country's goal which is competitiveness — investment in exports for acquisition of world market share.

Now if you looked at the United States, you would see exactly the reverse. You would see a strategy — buy now, pay later — promote, and preserve, and protect consumption. Write off your taxes, whatever you pay in interest, how much you borrow to buy anything. The world's most consumption-oriented set of policies and unprecedented government expenditures, at least in our era. Just those four little measures give you, over time, an idea of what this country's strategy is. I'll get back to that in a minute.

PERFORMANCE*	GOALS	CONTEXT
Gross National Product Consumption Investment Government expenditures Exports Balance of Payments Merchandise Services Capital Unemployment Prices Government Budget etc.	Standard of Living Income Jobs Competitiveness Autonomy	Domestic Institutional Government Industry Banking Ideological (accepted theory) Political Physical etc. International OPEC, Japan, USSR GATT, IMF etc.
	POLICIES Fiscal Monetary Trade Industrial Organization Investment	

*Trends over time

Figure 1. Country Analysis

Performance, also, is measured by the balance of payments. Current account; how we're doing on merchandise; how we're doing on services. The United States today has a minus \$170 billion trade account; \$50 to \$60 billion with Japan. We used to say that we could overcome deficits in merchandise by services, but that doesn't happen any more. Now we have a current account deficit, which means we are the world's largest borrower. We are getting lots of foreign investment which has implications for the future, and we're borrowing a lot, which has a lot of implications for the future, and for prices, and unemployment, and so on.

Why is Japan the way it is? Why are we the way we are? It has to do with our strategy, and strategy is goals, plus policies to fulfill the goals. The minute you talk about goals you run into the problems of compatibility, consistency, coherence of goals, or contradiction of goals. If you look at goals, let's say of Japan since World War II, it's a very simple goal. Catch up with the West, grow, invest, and export. The United States has much more complicated goals — the standard of living, defense, leaders of the free world, clean air, pure water, and so on, and so on. Many, many, many goals. Fight the Vietnam War, finance the Great Society, and so on.

We used to be able to meet many, many more contradictory goals than we are able to today. I've put up three goals here (figure 1) just to show you the example: the standard of living, competitiveness, and autonomy. It turns out these are contradictory, often and in many ways. If you want to have a high standard of living over the long run, you have to be competitive, which may mean that you sacrifice the standard of living in the short run. One way to do that is to borrow, or to allow foreign investment in, which threatens your autonomy.

The process by which those contradictions and goals are managed becomes very important to see. How good is a country at managing contradiction or at being coherent in the first place?

Oettinger: You made a statement earlier which I want to pick up before you go on. I thought I heard you say, inferring from these performance measurements over time, something about the goals. Stop me or redirect me if this is getting you off track, but the words that came to my mind come out of the intelligence realm, where there's a good deal of argument over performance or capabilities versus intentions. What I heard you saying in those terms was that for some measures of capabilities, or performance here, you were inferring intentions.

That seemed to me like a possibly dangerous leap, at least, if my relating this governmental, military, etc., kind of lingo to what you're saying is accurate. I may be off base, but I sort of like to keep looking at those issues.

Lodge: There are two ways of thinking about a country's goals. One is, you can read the President's speeches, and you can read papers the National Goals Commission is writing, which may not tell you very much. The other way to get a line on what a country's goals are is to look at what it does over time. If you look at what the United States does over time, there is one big thing that differentiates it from other countries, and that is consumption versus investment, which tells you that in the United States that goal, consumption, is very big.

Oettinger: In practice then, regardless of what the express statements say.

Lodge: That goal is very big, and national competitiveness isn't a goal at all. It is assumed. Now we also have autonomy as a goal, which of course means defense. Right now you've got a serious conflict between consumption, and competitiveness, and autonomy, which we see exemplified in the Defense Science Board report to the Defense Department on semiconductors.

The other part of strategy has to do with the policies a nation chooses to manifest its goals and to achieve its performance. These are familiar policies:

- Fiscal policy — that is, expenditures and revenues.
- Monetary policy (tight money, easy money, interest rates). Monetary policy is interesting because it relates to whether a nation actually can control its money. And that, in the case of the United States, is a grave question, because there are so many dollars outside the country, so you have to ask yourself, does that work?
- Trade policy — is it a policy of protecting uncompetitiveness, or is it a policy of promoting competitiveness? Japan has a policy, by and large, of promoting competitiveness; the United States of protecting uncompetitiveness. There's a big difference in terms of how you effect this.
- Industrial organization policy — is it kind of traditional antitrust, are four gas stations on the corner better than one? Or is it the encouragement of a combination for cooperation, for R&D, or for production in order to achieve competitiveness?
- Investment policies — is it short term, or is it long term, and so on?

This is a way of getting a handle on the country's strategy, or inspecting whether the policies fit the goals, and analyzing how a particular performance results from the two of them. It allows us to ask such questions as: What happens as you see performance deteriorate? What's going to happen if it is deteriorating? What effect will it have? You can't answer that question at all without looking at the context, domestic and international. You have to look out at politics, institutions, the role of government, the role of business, the role of labor unions, the relationships among them; the dominant ideology or collection of ideologies; geography, demography, all kinds of domestic features that condition and constrain policy choices and responses to performance changes. And you have to look also at the international context — OPEC, the Soviet Union, Japan, and so on.

I'm just putting this up as a technique of analysis for a country over time. At the Business School, for example, we start in 1853 when Commodore Perry steamed into Edo Bay and we look at Japan for a hundred years using this kind of a technique. By the time you get to 1980, you're pretty sure of what's going to happen. It's a way to avoid surprises. It's a way to see the inertia of history — institutionally and in performance. Similarly, if you start doing this with the United States in 1928 or so with Herbert Hoover and analyze the U.S. reactions to depression and war and other challenges, you get a pretty good idea of how the United States works.

Student: It seems like this can work for many countries, particularly western countries or pseudo-western ones like modern-day Japan, but what about the USSR? We look at prerevolution versus today, and the amount of change you have in such a short amount of time, relatively speaking. This is a vastly different system. Some would say not so vastly different, but considerably different as far as control and economic systems go.

Lodge: It would be very interesting. I've never done it. It would be very interesting to do. I wonder whether if you started in the Soviet Union before 1917, you would get a certain picture of a context — Czarist, whatever was going on in there. I've often wondered whether the revolution made that much difference in terms of the structure of things. Whether it just wasn't replacing God and the Czar with the People and the Politburo. Other than that, the constraints were not that different. Certainly, the international constraints didn't change much. They were afraid of their neighbors before and after.

So I think you'd find a lot of continuity in the Soviet Union. You see Gorbachev now trying to change policies and you get a feeling for the contextual obstacles he's got to deal with, especially ideology. The reason he's doing it, of course, is because the country's performance stinks.

Oettinger: Maybe a point here about ideology, thinking that it's different. It's a consequence of one kind of ideology versus thinking that its continuity is another. What George is describing does not strike me as a whole lot different from the problems that faced Peter the Great and the way he handled them.

Student: Once I started realizing it, maybe Cuba would be a better example, but then again you're probably going to find similarities in whatever type of systems you find. Still there are some basic jumps, some basic changes that occur throughout history, when you do have a considerable difference from one political system to another, or one form of economic exploitation that may have existed. Let's say the colonial type situation versus a post colonial period. Things that are considerably different.

Lodge: Theoretically, you should be able to see them. If the discontinuities in this analysis get bad enough, you will have a radical change in the context. That's what you will get. That's what you're talking about, I think. What would provoke a revolution, that is a fundamental change in roles, and relationships, and structures? What would provoke it would be prolonged lousy performance, or unacceptable goals, or inefficient policies, or something like that.

Student: As opposed to ideology provoking the other features. You're saying that this was going to provoke the ideology.

Lodge: Now that gets us to ideology.

Oettinger: Before you make that major jump, one more point on this related to what was just asked. Supposing that the discontinuity and so on had less to do with the real world, however defined, than with analytical obfuscation, accidental or deliberate. I can think of any number of changes in definition, some deliberate, and we see them contemporaneously inside the corporate entity or in a country where all these measures get sufficiently redefined, perhaps with some "throwing sand in the eyes" goal in mind, that makes comparisons before and after very difficult, if not impractical. It would seem to me that what you're describing in principle may, on occasion, even if there is no sharp discontinuity underlying what you described, be in practice

extremely difficult because the surface manifestations that are accessible, the statistics, etc., etc., have been so radically juggled that whether you look at it from the tax point of view, or a management point of view, or an international country analysis point of view, the data available just are not adequate or reliable.

Lodge: It's a great point. What we should add in the context (see figure 1) is theory, "accepted theory." Let's plug that into the United States. Accepted economic theory for the last 10 years has said that a deficit in the merchandise account is not important because we'll make it up in services. What are services? The biggest item is interest payments on the debt we have in Brazil, Argentina, and Mexico. You may question this as a basis on which to put the U.S. economy. Then it was said by the theorists, "Don't worry about the deficit, we can borrow. We've got friends all over the world dying to lend to us," and that has all of those kinds of implications. Now the United States is sustaining its standard of living and its defense commitments on borrowed money. This is by far the biggest national security problem we have, without question. Our goals are in grave jeopardy. But why? Because we are misled by accepted theory.

If some of you are traditional economists, you will probably argue with me, but that's the problem. Competitiveness, although I'm not going to talk substance, is a good demonstration. Competitiveness, you know, is supposed to be a buzzword in Washington. It's no buzzword. It's real and it's deteriorating, and it's been deteriorating for 15 years. Fifteen years; since Peter Peterson was in the White House advising President Nixon. We have been blind to that performance indicator because of assumptions. If you believe in free trade, free markets, free enterprise, that the exchange rate eventually will balance everything out into some great natural equilibrium, if that's your view of the world, then you cannot accept uncompetitiveness. It connotes a remedy which is worse than the disease. Government has to think coherently, and government has to have priorities. Government has to straighten out these contradictions. Interest groups need to be curbed. That, of course, constitutes a cleavage right in the context.

Let me just quickly run through the concept of ideology (figure 2) to make sure that first of all the definition is clear. It's such a loaded word and it has been so abused, and misused, and misunderstood, that it needs careful definition. I won't talk too much about this because you have had the reading.

What I postulate is that over here, you have "values" (see figure 2). These things are timeless, universal, noncontroversial notions inherently, which virtually every community everywhere that you can imagine has cherished. Whether you think of Gorbachev, or Deng Xiaoping, or Francois Mitterand, or Margaret Thatcher, or Ronald Reagan, or any of them making a speech, they all come out in favor of these things. I've never seen one yet who didn't. There's very little problem in getting people to agree that these are good things. Controversy sets in and the difficulties arise when a community, at a time and in a place, sets out to make these values live, to give them institutional vitality in institutions, in a real world (a "relevant context") of events, of facts, of phenomena, of insights, of theory, such as we talked about, of players, old players, new players, of behavior patterns, and so on.

Ideology is the bridge of ideas that a community uses to get from "values" over to the real world or "relevant context" in figure 2. You can divide it conveniently into five variables, such as individualism and property rights. You can look at all ideologies in terms of mixtures of two ideal types — variations or mixtures. In some places, the mix is well managed. In other places it isn't so well managed. In some places the costs of ideological tension, or of ideological incoherence, are very high. One of the things Vogel and I and our colleagues did was look at nine countries (figure 3). We ranked these countries in terms of ideological strength. What we meant by strength was not goodness or badness. What we meant by strength was two things; coherence and adaptability. Coherence has two parts: the absence of conflict among ideologies within the country, and the degree to which institutions conform to the dominant ideology, that is, the degree to which business, and government, and labor do what they're supposed to do, and the degree to which what they're supposed to do is clear and agreed on. That's one measure of strength.

The other measure of strength is adaptability. (The Soviet Union, for example, isn't very good on that measure.) Adaptability means how good, how flexible, is this ideology in terms of adjusting to changes in the real world.

On these two measures, we ranked the countries as in figure 3. This is very crude, very subjective. We spent two years studying these countries' ideologies. There were specialists for each country

VALUES	INDIVIDUALISM	COMMUNITARIANISM	RELEVANT CONTEXT
Survival	1) Individualism	1) Communitarianism	Geography
Justice	Equality (Opportunity)	Equality (Result) or Hierarchy	Demography
Economy	Contract	Consensus	Economic Performance
Fulfillment	2) Property Rights	2) Rights and Duties of Membership	Technology
Self-respect	3) Competition to Satisfy Consumer Desires	3) Community Need	Scientific Insights: Newton Einstein Ecologists, et al.
Etc.	4) Limited State	4) Active, Planning State	Traditional Institutions vs. New: e.g., OPEC, Japan
	5) Scientific Specialization	5) Holism	Traditional Behavior Patterns

(Source: Lodge and Vogel, op. cit., p. 11)

Figure 2. A Bridge Between Values and the Relevant Context

IDEOLOGY RANKING	ANNUAL COMPOUND GROWTH RATE OF REAL GNP PER CAPITA 1965-1984 (Percent)	PERCENTAGE POINT CHANGE IN EXPORT SHARE OF WORLD MARKET (Less Oil Exports) 1965-1984	AVERAGE SHARE OF INVESTMENT IN GNP 1965-1984 (Percent)
	Rank #	Rank #	Rank #
1 JAPAN	3 5.27	1 4.4	1 29.0
2 KOREA	1 7.22	2 1.5	3 22.9
3 TAIWAN	2 6.78	3 1.4	5 19.4
4 GERMANY	6 2.66	7 -1.0	2 23.3
5 FRANCE	5 2.90	6 -0.6	4 21.0
6 BRAZIL	4 3.44	4 0.6	8 17.5
7 UNITED STATES	8 2.02	8 -4.0	9 15.4
8 UNITED KINGDOM	9 1.74	8 -4.0	7 17.7
9 MEXICO	7 2.33	5 -0.2	6 18.1
RANK CORRELATION	.83	.72	.77

(Source: Lodge and Vogel, op. cit., p. 307)

Figure 3. Indices of Competitiveness

who were very good on the country, and they spent time trying to figure out how to use ideology. We could argue a long time about whether that ranking is correct, but that's how we decided to order them.

Then we also have here three measures of competitiveness (figure 3): growth rate in per capita GNP, percent change in export market share, and average share of investment in the gross national product. You will see that the correlation between ideological strength and competitiveness is pretty close. What that says is that ideological characteristics have a good deal to do with how successful a community is, if you use competitiveness as a measure of success.

Oettinger: Was there an index against adaptiveness, an index that was adapted to this or coherence of ideology?

Lodge: Let's take traditional ideology, say individualism in America in the late 19th century. For a while institutions conformed more or less to this set of ideas. Business does what it's supposed to do. Labor does what it's supposed to do. Government stays the hell out of the way, and so on. Then

things happen. New technology comes along. Business gets big because of the technology. Demographic flows push people off the countryside into the cities and so on. The Depression comes. Government gets big. Institutions start drifting away from the old ideas, and you get a gap, which you might call a legitimacy gap (figure 4). For a whole lot of reasons that have nothing to do with ideology or ideologues, practice is forced away from ideology. Now as this happens, the institutions lose authority, lose responsibility, or the definition of responsibility erodes. They lose legitimacy.

Back at the turn of the century Andrew Carnegie or somebody knew what he was doing. God was on his side, there was no doubt about it. Today, the poor American business manager is torn this way and that, serving so many stakeholders that he doesn't know what he's doing; he's desperate. That legitimacy gap is one measure of incoherence. It causes wasteful ambivalence. It also causes inadvertence, because people do things up here (figure 4, point B) without knowing what they're doing, and without understanding the full implications of what they're about.

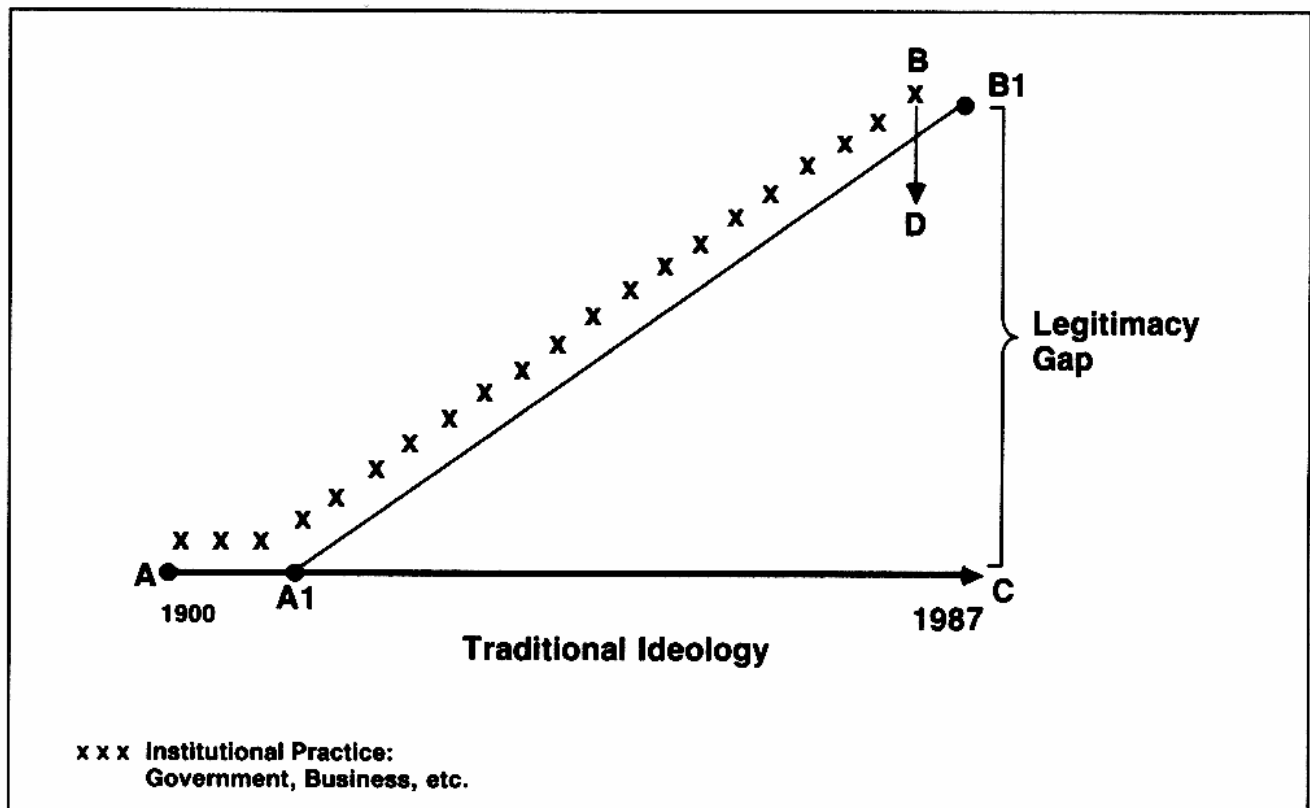


Figure 4. The Legitimacy Gap

Let's take the semiconductor people and the Defense Department. The independent semiconductor industry, not IBM and AT&T, but the independent industry, is in trouble, as you know. In fact, they're about to bubble out. The Defense Department thinks that's a bad idea. The industry says we need two things if we're going to live. You've got to set aside the antitrust laws, which is number three in ideology one, and you've got to give us a couple of billion bucks just to get us going, which is a violation of number four (the limited state) in ideology one. So, they're already way up here.

The only way you can justify that is by going to number three in communitarianism, which is community need or national interest. Question: Who decides community need? In this instance, it's the Defense Department, military security. Is that legitimate? Is that acceptable? Is it effective? It depends on what you want. If you want a commercially competitive semiconductor industry, you may not want to define it in military terms. The Defense Department invested \$1.5 billion in the machine tool industry in the 1950s. What was the effect? About 10 different, very complicated, very expensive machines which I guess make good airplanes, but which were a competitive disaster for the industry. Japan, adopting a very different strategy with less government money, came in with simple, inexpensive equipment, and then worked up the technology ladder to acquire the market.

When you go to community need, it's really important to define it to make the definition legitimate. Is the Defense Department going to be our MITI? What happens to other industries that may not be that close to defense, like biotechnology, or fiber optics, or telecommunications, or these other things that are in trouble? That's inadvertence.

There are two ways to close the legitimacy gap in figure 4. One is to pull the institutions back (BD), i.e., to enforce the antitrust laws, make shareholders own so that property rights live, etc. This hardly ever works because institutions are up there at point B for a good reason. You couldn't make most shareholders really own if you wanted to. It's structurally impossible. The only other way to close the gap is to change the ideology (A, B). That sets up a problem or ideological conflict, because old ideologies never die, they stay around. So, you have two ideologies. In a way that's Britain's prime problem: two ideologies, very poorly managed. France has four of them, well managed.

One way of thinking about a nation systemically is to make a picture like figure 4. Mexico is a disaster, because Mexico doesn't allow pragmatic departure from the revolutionary norms. You have a country whose institutions and whose ideology are increasingly incompatible with survival in the real world. There's a case for revolution. If you make a country analysis of Mexico, radical structural change is virtually inevitable, but because of ideological inflexibility it will not come easily or perhaps gently.

Student: You can have congruence between ideology and institutions within a country, but it's still irrelevant to the real world because the real world has changed? Probably at some point in time it was relevant and it worked or it wouldn't have come into being. What makes it not work any longer?

Lodge: Actually Mexico and the Soviet Union are somewhat similar. Both have very powerful, strong revolutionary ideologies, which have become progressively less adaptable, progressively less practical in the real world, and progressively more expensive. Both are trying to change. It is very difficult.

Student: The last time a country tried to change, and one I can think of off-hand would be something like Iran, it ran into a counter-revolution of sorts.

Lodge: Iran is fascinating. I had an Iranian student do an ideological analysis of Iran just before the Ayatollah, just looking at what the Shah had done to the dominant ideologies. There were sort of three dominant ideologies that we found in Iran, and the Shah had violated all of them. We didn't really know it at the time, but we said, "Gee, this guy's in trouble." Now, of course, the Ayatollah comes in and strengthens one of them in a big way. I don't know about the situation now, or where it's going.

Oettinger: You said France had four ideologies. Could you sort of enumerate so that I can get a picture of what you mean by that? And then you got onto this track by virtue of explaining the ranking scheme earlier, and I wondered if you could go back, because I'm still not sure what the essence was of the ranking that you had described.

Lodge: The essence is the degree to which there is coherence among ideologies, and the degree in which practice is in line with the dominant mix.

Student: Is that what you meant by coherence earlier?

Lodge: That's one measure. The other measure is adaptability. Mexico fails on adaptability. The Soviet Union fails on adaptability.

*Japan's Ministry for International Trade and Industry.

Oettinger: So, coherence in this way and adaptability were kind of the ingredients that you and Ezra Vogel used to make this ranking. So number one was most coherent and adaptable and the last number was least coherent and adaptable.

Lodge: That's right.

Student: Does that mean, for example, that you regard Korea as fairly adaptable?

Lodge: We had a good deal of trouble with Korea. Vincent Brandt wrote the Korea chapter. In spite of the political tension and instability, we judged the two Korean ideologies to be coherent and adaptable. One of the things that came out of this study that was most interesting to me is how radically different Korea, Japan, and Taiwan are ideologically. Korea seemed to us to have two ideologies: two versions of communitarianism, one much more individualistic than the other.

We felt that whatever the instability there today, and whatever the unrest, the capacity to adjust those differences was very high. We did not see any kind of falling apart of Korea.

Student: There is the fragility thing in any nation that depends enormously on exports. I can often sense that there's a certain amount of fragility in Japan because competitiveness and ideology lose some meaning, and some of the communitarian aspects. The high employment level, all these kinds of things depend so heavily on exports that they are really suspended very narrowly in a certain sense.

Lodge: You mean if growth stops?

Student: They're more dependent on us than we are on them.

Lodge: A bicycle analogy. Can Japan hold together with low growth? Our view of it is this: that they're not going to suffer low growth. Their ideology and their institutions are so adjustable, so adaptable, that they are going to continue to grow at very much the rate they're growing now. They are going to continue to be a number one problem for the United States. They are dependent on us, and so they're going to prop us up, and that's a good thing, and they're going to invest here. They're going to try to make sure that we don't have a deep recession. They may not be as successful at that as they are at their own business. But they're going to try to, because we are a big menace, or a big problem for them financially.

Student: It seems to me there may be a third way to adjust this disequilibrium that you've been talking about. It has to do with reality and more ideology in

this gap. If you were strong enough and powerful enough, can you change the world? Change reality to perform closer to your ideology and thus make it more relevant? I take protectionism as an example. If we got totally protectionist with Japan and said, "No more cars tomorrow, no more TVs, no more Walkmans, whatever," that would be changing reality, changing the rules of the game.

Lodge: Well yes, but first you'd have to make a very careful study of the way in which the world economy is now working. That's an interesting question. Let's say that we will have such a difficult time dealing with this tension that we're going to become progressively less competitive. More and more of our companies are going to leave. You know Albert Hirschman's book, *Exit, Voice and Loyalty*, that's an interesting concept here as well.* What's happening now is that because of this ambivalence, because of the difficulty of switching from one system of management to another system of management, and from one set of goals to another, and one set of policies to another, the competitiveness of the United States is deteriorating.

Companies, in response, are in many cases leaving. It's important to note that the competitiveness of a country may have very little to do with the competitiveness of companies. General Motors becomes competitive by shutting down here and going somewhere else: Korea, Taiwan, Brazil, Mexico, wherever. That's taking what Hirschman calls the "exit" option. There is a "voice" option which is to stay and change the company and the system. One is not enough, probably. We see companies who can't leave doing that. Defense companies — they can't leave. The arbiter is loyalty. If you are loyal to your shareholders, running up against an uncompetitive system with huge deficits, relatively high interest rates, and crazy antitrust laws, adversarial labor management relations, unions that don't understand the communitarian way, managers who are hung up on short-term return to shareholders because of the old idea of property rights, and a cost of capital that's twice what other systems provide, leaving is not surprising if you want to keep up your return to shareholders. It's good for the company; not very good for the country.

If you are loyal to the company as employees, or to the country, you will stay and fight. You'll stay and fight to change the company, as is now going

*Hirschman, Albert O., *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations and States*. Cambridge, MA: Harvard University Press, 1970.

on, most dramatically at Ford, Honeywell, AT&T, Hewlett-Packard, Texas Instruments, and IBM. You'll stay and change the company and eventually, if your ideology doesn't get in the way, you will try to change the system. That is, you'll go to Washington and say, "Come on, White House, open your eyes. Understand reality. Start thinking about bigger priorities. Let's not have a tax reform act that makes the problem worse instead of better." We've got to get our act together the way we have in our past in the United States. We haven't always been this way. Every now and again the United States has been communitarian in the early 1800s, the Depression, World War II, the space program. We've got it in our genes back there somewhere, but it doesn't crop up very often.

But that's what you would do. Now, it's a close question what's going to happen. When I go out to talk to managers about changing their human resource management, for example, I tell them that if you want to get high commitment, high productivity, innovation in technology, and so on and so on, you've got to have a work force that's, first of all, committed to the firm. You've got to abandon the hire and fire mentality. You've got to provide employment security. You've got to invest hugely in training. There's got to be a career for the employee, and you've got to do away with artificial levels of hierarchy, involve the employee in the design of the work, and do all the things, let's say, that Chaparral Steel does — it has the highest productivity of any steel company in the world, in Texas — all managed by its employees, run by its employees. The difference between manager and managed is insignificant. There are no workers. There are no managers. It's a different concept.

If you go out and talk like that, you run into one hell of an ideological problem. I remember talking to management at Eastern Airlines. A magnificent case of mindset killing an organization. Not just management, but labor also. On each side were dyed-in-the-wool Lockeans. I mean religious Lockeans. They worshipped at the altar of individualism. Their organization was going right down the tubes because of the high costs that their particular way of looking at life was causing. At one level of their minds, they knew they had to change. They had to be cooperative. There had to be a consensus. They had to involve one another in work and so on, and they were changing in fact, but they couldn't change their heads.

They had worker representatives on the Board of Directors, but for management that was a problem.

The worker representatives were somebody to be out-voted. They were not to be included.

Oettinger: A question of both substance and technique there, because you say you're making a lot of the ideological variable there, and we may have a laboratory experiment then because a sister company now also under the Texas Air umbrella is People's Express (PE), where the ideology was very different, in fact, I may be wrong, but it sounds like what you described in the steel company. The steel company is doing fine. The airline's gone down the tubes just like the other one. Is the ideology the controlling variable and analytically useful there?

Lodge: Just to finish Eastern and then I'll get to People's, because it's a beautiful sequence. I really think Eastern's death as an independent company was basically a mindset problem of two leading characters. People's Express came in without any question with a communitarian concept. The problem was, management really didn't know that that's what they had. As PE got big, managers neglected to put in the mechanisms to implement the governance procedures which had been implicitly initiated. There's a beautiful example of inadvertence, and ambivalence. Then PE did some unwise things like buy Frontier Airlines. Two things killed it: bad judgment in business terms, overextending itself, and, secondly, not really understanding the full ideological implications of what they were doing. If PE was going for this flat hierarchy, participative kind of an organization, they had to build in the mechanisms to make it work when it got very big. When it was small it didn't make any difference. As it got big, you couldn't do that without having mechanisms.

The first thing that happened was the pilots got angry because there were too many of them to be involved in the operation. The manager no longer could have his open-door policy; there were 3,000 people. He had failed to plan the governance moves or mechanisms.

Student: Will this sort of thing happen to your small steel company if it becomes large?

Lodge: Unless it knows what it's doing.

Student: Do you have an example of a large company that operates on this basis?

Lodge: Well, IBM is a pretty good example. Lincoln Electric is a kind of an anachronistic, but classic example, but it stays the same size. There are two things, I think. First of all, it's not so much

the overall size, it's the size of the decisionmaking unit that is critical. IBM is very big, but they manage to divide their decisionmaking into pieces that work pretty well and everything that goes with it — the compensation schemes, and the incentives, and so on. If you know what you're doing, if you know which ideology you're in, it serves as a very useful way, a very useful set of checklists. For example, if you are in a communitarian framework the idea of consensus replaces the idea of contract.

Then you've got to think about mechanisms for consensus. Do they work when you get bigger? Do they work for all kinds of employees? Some employees need some mechanisms, some need others. What happens to the person who doesn't fit? The contract was invented to protect the individual from the "groupiness" of the Middle Ages. Now we're going back to "groupiness" in the name of competitiveness. What happens to the guy who doesn't fit? That has to be managed if you want to keep mavericks, and innovators, and sort of nutcases in the system, and they don't want to sing hymns and do calisthenics and all that stuff.

Student: How does this align with the labor movement we saw around the turn of the century?

Because it sounds like a lot of what you're talking about would fall into those old debates.

Lodge: The union movement, by and large, grew out of management practices which in the name of scientific management of Frederick J. Taylor and things like that disenfranchised, devoiced, and dehumanized the worker. What the union did was to come along and create an adversarial institution inside the corporation. We are going to be the representatives of the powerless, atomized worker, against the management. So you had a picture that looked like this (figure 5, Model 2).

First of all, the traditional model (Model 1). This is sort of a prototypical, Lockean, individualistic model. Owners, higher managers; often the manager owned some. Kids come out of the hills hungry for work. This is sort of the early days of the automobile industry; Robert E. Olds, Louis Chevrolet, all those characters. They crowded into Paradise Valley. No food stamps, no unemployment insurance, no minimum wage, none of that nonsense. If you didn't work, you didn't live. An individualistic contract, hierarchical, legitimated by the idea of property rights which came from God.

It worked okay, but the company got very big, very technocratic, with the assembly line and

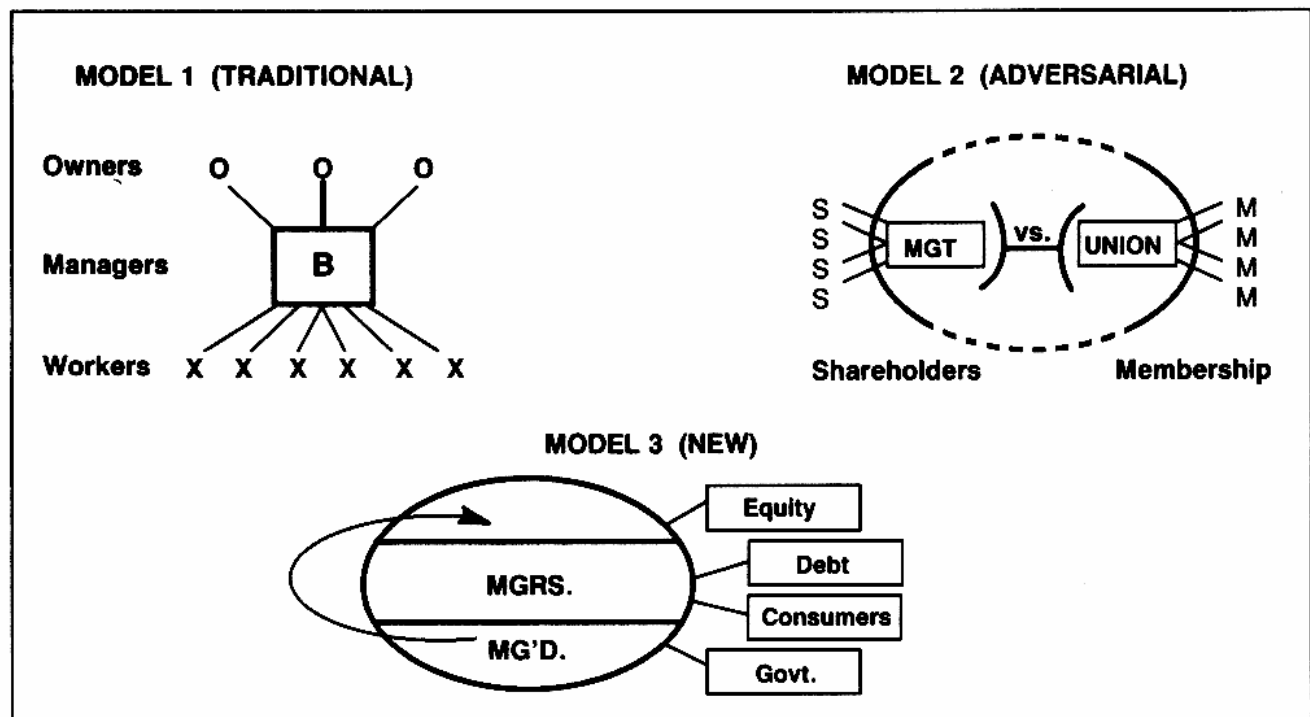


Figure 5. Models of Corporate Governance

individuation of these jobs. So, you had a breakdown of that model, especially with the Great Depression. What the Great Depression showed was that Model 1, with the limited state, did not ensure survival or justice. Ideologically, that's what happened. The real world came along and people said, "No, we've got to have an adjustment." They didn't say it ideologically, and they didn't say it for ideological reasons, but that's de facto. So, the role of government changes. Government got into the business of defining rights and duties, of defining community needs, of not just protecting property rights and contracts.

In fact, there was a wonderful moment in 1936 when General Motors said to Governor Murphy, "Send the troops in to get rid of John L. Lewis and UAW," who at that time were in a sit-down strike in the plant in Flint, Michigan. General Motors said this was a violation of property rights. Governor Murphy had the National Guard outside drilling. John L. Lewis came in to see the governor. He said, "Governor, those troops go in over my dead body." Governor Murphy backed down.

There in a little moment was an irreversible ideological change in the United States. Everything after that was different, the National Labor Relations Act, and so on. The contract is collectivized. The job of management is to maximize returns to shareholders who become increasingly dispersed, a million and a half of them. You couldn't find them if you had to, but they're out there somewhere.

How do we know what they want? In the old days (Model 1) we could talk to them. We could say, "What would you like? Short-run bucks, or long-run market share?" We can't find them now. How do we know what they think? Traders. Traders on Wall Street, acting second by second.

Over here we have the union. What's their job? Maximizing return to membership. What happens? Naturally, costs go sky high. Motivation goes down. Productivity goes down. Alienation, absenteeism, rigid, legalistic rules tie up the institution. So, that breaks down. It's doomed. We see something else coming along. We don't know what it looks like. We call it Model 3. There's just nothing else to call it. Infinite variety. We see it happening at Ford in the employee involvement, the quality of work, all kinds of things.

There are managers, there are managed, and the right to manage seem to be coming from the managed. What happens to shareholders? What happens to shareholders is there's an equity marketplace out here. There's a debt marketplace. There are con-

sumers, and there's government. Four places you can go for money.

Theoretically, everybody inside the circle — the company — has the same interest in being able to get financing from any one of these sources — if everyone has employment security, that is, if everyone has a career interest in the health of this enterprise. Then you have to decide, well, do we want to get it by paying dividends; do we want to get it by paying interest; or do we want to make it cheaper and better and expand market share; or if we're big and politically important like the semiconductor people, we can go get it from the government. That's the new model.

This is very much a Japanese model. In Japan shareholders don't count, these other people — the banks, and government — are tied together, and companies know how to get market share among consumers.

Oettinger: That's an interesting point. The growth rates of the United States over the last 5 to 10 years in entertainment — which is most directly linked to the consumer end of the financing spectrum — have been spectacular when everything else has been going down. It's interesting because I have not seen it in that way. That's a fascinating insight. That had not occurred to me to look at these as four categories of financial resources. If you look at the Forbes data on growth in the last few years, the consumer finance things are staying up as almost being miraculous looking.

Lodge: It's a good way to do it because the cost of equity and debt capital is about twice what our competitors pay. Equity capital is very expensive, and debt capital in this country, especially for those involved in foreign competition, is very expensive. Our government heavily subsidizes industries which are already thoroughly insulated from foreign competition; like housing, and real estate, and milk, and sugar. We leave exposed those exposed to foreign competition. So, again, we have a strategy. It's just the world's least competitive one. You can see how it derives because if government is supposed to be directed by the pulling and hauling of interest groups, naturally, that's what you're going to get. It doesn't work in the competitive environment in which we now live where trade is about 16 percent of the GNP. When trade was about four percent of the GNP it didn't matter.

Oettinger: What you seem to be describing here as a technique, it seems to me from what you illustrated here, requires that the analyst who prac-

tices it essentially leave no rock unturned in terms of the corporate, or the country, or whatever assumptions. Can you tell us a little bit about the extent to which what you practice, or what you preach, within the Harvard Business School is practiced or preached elsewhere, and at what price by its practitioners, and what receptivity by their intended audience? Because it seems to me that in many institutional settings it would require almost heroic stands to raise the kinds of questions that are implied by this approach.

Lodge: That gets you into the problem of academia, and the difficulty that academia has understanding systems. Talcott Parsons wrote somewhere that change was too complicated to be addressed by sociologists. It was too systemic. One of the first things I did in trying to learn how to be an environmental analyst was to spend three years off and on in a rural province of Panama watching a radical bishop change the province. That got me to Vietnam, actually in 1966 and 1967, as a consultant on how you change environments. I was there as a consultant to AID (Agency for International Development) looking at the People's Action Teams and the Revolutionary Development Cadres. I'll be glad to go into that, because it was a disastrous example of the lack of systemic understanding.

Out of this land reform thing, it became crystal clear that the economists and the economic development specialists, who were then dominant in AID's development thinking, were actually doing more harm than good. That is, their specialized way of thinking was resulting in the sustenance of the status quo, creating obstacles to change when their purpose was to promote change in the way of land reform, productivity, etc., etc. It was a classic example of where an imperfect understanding of the environment that comes from a specialized approach was leading to misunderstanding and disaster.

In putting together the course where we teach this, we have to recruit people to do the work — historians, economists, one thing and another. One of the biggest problems is that they have to abandon — if not forget — their disciplinary pursuits, because they have to think in an integrated kind of way, and they have to dig up facts in this way. It turns out that historians are the most adept at this. Economists have the biggest trouble.

Oettinger: Do you use philosophers? I find that my collaborators who come out of philosophy almost always use historians.

Lodge: I'm not sure we've had one, but I would imagine we have. Some sociologists sometimes, like the Ezra Vogel variety sociologist. You can see how disastrous specialization in academia has been for this kind of approach, whether it's country analysis or ideological analysis. Vogel and I, partly to sort of test this, got together these seven people, including Jorge Dominguez, whom you know, an outstanding authority on Latin America, and the others. They were political scientists, government specialists, and so on. They found it positively exhilarating to break down the walls of their speciality and look at their countries in a broader way than they ever had before. They found it exciting and exhilarating and I don't think too difficult.

You asked me whether it's happening in other places. I can't say. Here and there, perhaps. But it is so difficult for academics.

Oettinger: I'm not surprised. Some years back we had Lionel Olmer talk about the A team, B team experience in the CIA, as an attempt to look at one problem from two sets of differing assumptions or ideological standpoints.* It turned out to be extraordinarily difficult. I was wondering if you had any thoughts on making headway. You're saying it's a very difficult thing to do.

Lodge: I don't think it is actually a difficult thing to do. I mean, if people wanted to do it, it wouldn't be difficult. I do not really think it's that difficult to apply this concept for productive use. There's no shortage of data. There's no shortage of information about these places. The problem is the conceptualization you use to put the data together. Maybe I'm being immodest, but I think what you've got here is two simplifying frameworks for taking data which is clearly available and putting it together in a way that has punch. That is, it allows you to see the implications for institutions and decisionmakers. That's what we're trying to do over there, unlike some who think in these ways a little bit, but are not interested in what it all means for decisionmakers. This is a formulation that is applicable to people who have to decide things, whether it's policy, or adjustment to policy, or roles, relationships; then this is useful.

I made a presentation in 1973. I was doing a paper for the Trilateral Commission — Europe, Japan and the United States — on the changing role

*Lionel Olmer, "Watchdogging Intelligence," in *Seminar on Command, Control, Communications, and Intelligence: Guest Presentations, Spring 1980*. Program on Information Resources Policy, Harvard University, Cambridge, MA, 1980.

of American labor unions. Even then it was clear as a bell to me that the old Model 2 was broken and it wasn't going to be fixed. Everything with it was broken. The National Labor Relations Act, the Industrial Relations Specialists.

We made a presentation to the executive committee of the AFL/CIO, Lane Kirkland, and all the union presidents. Lane Kirkland got very angry at me, and Glenn Watts of the Communications Workers, whom you know, said, "But, Lane, George is just the messenger." It was just so ideologically revolting.

Oettinger: The rice bowl was also threatened. What you're saying is that the adversarial negotiating process is breaking down; that no amount of mediation, as opposed to "I'll see you in court" is going to fix it. You just may put a bandaid on it. You are bearing rather bad news when you say it's broken. The fundamental mechanism is dying.

Lodge: What it means is that the American labor movement must define a new mission if it is to survive. It doesn't mean an end of the labor movement. I am a staunch believer in the labor movement as a necessity for a democratic society, but the mission has got to change. Of course, that's very troubling just as it is for managers. It may be easier for them, because they feel the shock of reality more clearly. As they go down the tubes, they know they've got to change, or die, or leave. Some of them don't want to leave. They like to live in Minneapolis or whatever. So they must change.

Oettinger: They get performance indicators better than let's say the military. I was contrasting before the degree of feedback that the military gets, thank God, not very often, on the quality they get, versus the businessman in terms of performance. The feedback is on performance. I guess what you said began with using performance indicators as measures of goals, or as indicators of goals, so it becomes so important. All you can see is performance. What you're suggesting is that if you've used your kind of technique then you're looking at performance indicators in a different way. You're using them then to indicate a sense of implied goals and to see whether those implied goals bear any relationship to what you think your goals are — either your own goals, or your assigned goals, or the goals of the country's ideology. In a very natural way then, if you take the frame of mind that you're describing, you would get an indicator of

whether or not where you think you're going and where you're actually going bear any relationship. That's the heart of your technique.

Lodge: That's the heart of it. Let's take performance. The way in which most managers are measured is performance in terms of quarterly dividends; earnings per share. That is disastrous — it's feedback. It's a disastrous feedback if what you're trying to do is make a firm which is competitive over the long run. How are Japanese managers measured? They are measured in terms of the degree to which their enterprise, or their operation, contributes to long-run market share. Who's going to win? It's not a difficult question to answer. The mere presence of performance standards is not a guarantee of a success. It's got to be standards that are compatible with a reliable goal.

Student: Are you saying that ideology is the reason for that difference?

Lodge: In that case, yes, because if you hold the purpose of the corporation to be satisfaction of shareholders, which the individualistic idea number two says it is, then you're going to have this problem. Not only this problem, but the T. Boone Pickens problem, and all the rest. The corporate raiders are absolutely right, if you accept the premises of the traditional ideology. Shareholders do better with corporate raiders. If you say what's in the national interest, they're a disaster, but you have to use a different performance standard.

Student: How do you differentiate them from the green-mail kind of guys where the shareholders usually come out on the short end?

Lodge: I think that's indefensible on either side of the premises. I think it ought to be made illegal. I don't see how you can make Boone Pickens illegal unless you come up with a different set of purposes for the corporation. If you say the purpose of the corporation is to make America more competitive, then you can put Boone Pickens out of business, because he encourages a short-run fix. He discourages investment over the long run. He exploits the system for his own enrichment. It's perfectly legitimate, unfortunately, given the criteria of the system.

Student: You're suggesting that in a sense the national ideology, the standard of living, is a sort of an analog of the labor union? You're trying to get more for labor. The standard of living is the national manifestation of that. It's a distributive sort of thing. How do you see this moving onto a national

coalition when the current political system is breaking down? How do you see that?

Lodge: That's another nice example of theory out here. The way in which the United States theory has developed, the way in which Keynesianism has been interpreted by both Republicans and Democrats, has been demand management. It's been a consumer-oriented, distribution-oriented, set of policies. In the tax reform act, people were thinking not about the supply side; they were thinking about closing loopholes and making a stand. A distribution-oriented, consumer-oriented, way of thinking. The other way of thinking about a system is producer-oriented, the production side. How do you increase investment? In what fields? In what areas? How do you bake the economic pie?

Our system, and many of the systems in western Europe, are oriented towards dividing the pie. The assumption is that the pie is going to be there. That's an erroneous assumption. If you look at the Japanese system, or Taiwan, or Korea, it is focused on baking the pie, not too much on distributing it, although there is a strong ethic of fairness, of egalitarianism, in both the Japanese and Taiwan ideologies. Income gaps, for example, are much less than here. In a way, oddly, Japan is more democratic in the workplace than the United States is. One of the things that Toyota shows us in Fremont, California, where they're running the General Motors assembly division, is how to be democratic.

A consumer mentality versus a producer mentality. We're going to have to go to a producer mentality. We thought we were with all this supply-side talk, but we weren't. The 1981 tax cut was a massive subsidy of consumption. Why? Because the idea of government held by the perpetrators of the Act precluded channeling the revenue into investment. It could have been done, as Japan, and Germany, and many other countries do, but that would have been in violation of the Lockean notion of the role of government with which the Reaganites came to power. The 1981 tax cut was a pure, unadulterated disaster, partly due to uninspected ideological assumptions.

Student: Are there differences between the 1981 tax cut and the 1961 tax cut, like Kennedy, that did in fact stimulate the economy?

Lodge: It was accompanied by a huge investment tax credit. In other words, it was channeled.

Oettinger: It was producer-oriented. In that sense the 1986 one was more like 1981, much more consumer-oriented.

Lodge: For the United States to reverse the trend, there's a question of fairness. It won't be politically acceptable if everybody doesn't share the pain. Here is where some of the glaring inequities in our system have to be addressed. Let's take the difference between the CEO salary and the shop floor. You can't expect workers to take a wage cut to recover long-run market shares if the CEO's going to be getting a million dollar bonus. With the necessity of looking at the baking the pie side of things, a whole lot of questions are going to have to be asked that we never really focused on.

The idea of equality of opportunity has given way to equality of result, affirmative action and all that. There are some things happening which indicate that that idea is not very practical, particularly in education. In schools, for example, if nobody fails — equality of result — you produce people who can do nothing else. You see a lot of talk nowadays about how we've got to educate a knowledge elite to really understand what's going on with computers and all that. We are reminded that in a communitarian society that slot has always been occupied not by equality of result but by hierarchy.

In Japan it's a meritocracy. You start taking exams at the age of three and you emerge somewhere along the line: summa cum laude go to MIT, magna to the Bank of Japan, etc. In some places it's a theocracy, or an ethocracy, or whatever. The management of the hierarchy is crucial. This is a good example of the dangers of inadvertency. We may be going to hierarchy without knowing we're going there. Who's at the top and who's at the bottom? At the moment we've got about 23 million people at the bottom, the so-called underclass: unskilled, dropouts, unmotivated, addicts, and so on. We've got a little elite at the top. We're trying to get the people at the bottom to jump into the economy. No more food stamps; no more welfare, and so on; "Lazy bastards, get up there."

What's going to happen? Are they going to jump into the legitimate economy? With increasingly high skill needs? Increasingly demanding job requirements? Or are they going to jump into the criminal economy? In my own mind there isn't much question. We are building a time bomb, right here, by not understanding where we are in ideological terms. If you have a hierarchy, you've got to manage it. That means all kinds of things, but we're not thinking in those terms, simply because it is detest-

able: that is, to say to Americans, "We've got a hierarchical society," is fundamentally revolting. One of the difficulties here is that it is so hard to talk about. It's hard to talk about in firms; they hire me to come and do the dirty work. I say, "Why can't you talk about this without me?" Well, it's sort of like talking about politics, or religion, or sex, or something. It's perfectly easy if they will only do it.

Student: It seems to me that the stress of trying to solve this trade problem by adjusting interest rates forcibly is one way of avoiding the problem of addressing the standard of living, distribution, and so on domestically.

Lodge: Do you mean borrowing?

Student: Trying to force Japan, Taiwan, Korea to raise their exchange rates. Is it one way politically, domestically, a politically cheap way of trying to avoid the problem, the standard of living?

Lodge: Yes. It's also, you see, one of the sinister things about borrowing. As long as we are able to go on borrowing from Japan, in particular, but other places, nobody thinks there's a problem. You ask the average person in the street if there is a problem. "No, I'm doing okay. Everybody's doing pretty well. No problem." That's the sinister thing about living on borrowed money, until you have to face the music. The crisis, when it comes, is going to be far bigger than it need be if we were facing reality as a country.

I was in Washington recently at a Carnegie Endowment for International Peace meeting on the Middle East. There was an Israeli there, and he was complaining that the Defense Department was pushing all this money on him, airplanes and stuff. It was \$4 billion this year. He said, "\$4 billion to Israel and under the terms of the Camp David agreement that means \$4 billion to Egypt. That's \$8 billion. Where are you people getting all this money?" Somebody said, "Well, we're borrowing it." "Where are you borrowing it?" "Japan mostly, but I suppose the oil producing countries, at least some of them without any people like Abu Dhabi, and Kuwait, they must still be lending us some money." The Israeli said, "Yes, that's what worries me. How long are they going to be willing to lend you the money to buy the F-16 which might drop the bomb on their central bank?" The tie-in of these issues is crucial. How reliable are we as a country if our defense commitment is financed by borrowed money?

Oettinger: Let's examine that. Supposing that the Japanese logic — take that particular example — is that it buys them stability in the Middle East whence their oil cometh by funneling it through America. Is that any crazier than this scheme that the folks in the White House hatched up? It's a money laundry for a country that is prohibited by a Constitution we imposed on it from looking after its own defense, and so they are laundering their defense money through the United States to funnel it to Israel and Egypt in order to keep their pipelines open to the Middle East. What could be more logical?

Lodge: That's a good argument, but I'm not sure about Abu Dhabi and Kuwait. What we'll say is, "We don't want some money, but we'll take some money." Whom we borrow from makes a difference.

Oettinger: I am taking, I think, your analytical technique and pushing it a bit further. Under that viewpoint, implied in some of your opening comments, you were talking about the deficit in the merchandise, and the deficit in services, those two combined being made up in the capital accounts. We're going to run out. But supposing, here is Japan with no defense budget or a minimal one. And suppose you take that \$4 billion or whatever the hell you were borrowing from Japan, as being the moral equivalent of their defense budget, and it shows up in the United States in the capital account and is perfectly reasonable mutual security that happens to take a rather peculiar route. For the sake of argument, accept that for a moment. If that were the case, it is consistent with certain goals and a mechanism which may be a little bit odd under another ideology, but for which I've now constructed an ideology whereby it would make perfectly good sense, and the problem in your terms is now that the practice and the ideology are at odds.

Lodge: The problem is that they're going to want to be paid back. With our debt mounting up the way it is, and interest payments and compound interest and all that, we are going to owe the world a hell of a lot of money.

Student: In U.S. dollars mostly.

Lodge: Yes. But still they're going to want it paid back. At some point, we're going to have to run a surplus in the current account.

Student: Or go through severe inflation again. Produce more dollars.

Lodge: We could do that. Then imagine the kind of inflation we'd have to run to do that, and what

effect that would have on the domestic economy. I think no matter how you look at this debt thing, we're going to have to face some kind of music sometime, whether it is huge inflation, or becoming competitive. You can become competitive if the value of the dollar goes down far enough. Of course, we will be competitive. What that means in terms of standard of living is grotesque. Will we be able to take that politically, and so on?

I'm getting into speculation here, but to me the realistic way to think about the future is that it's rugged. The surprising thing to me is the extent to which we are being, I think, fooled, as a people. Ideology plays a role in denying reality. I wrote a book called *The American Disease*, which you can get at the Coop at a modest price. The disease is about the denial of reality — a psychological disorder well known among adolescents who can't face the grief of adulthood, and take off into a fantasy world induced by drugs, or drink, or late-night TV. They think John Wayne rides again, or something. There's a well-known psychiatric treatment. You have to force them to look for those elements of their traditions and heritage which are compatible with reality. Massage those and get them up to the front and suppress the fantasies, and the dreams, and the unreal. That's what you do. That's what we have to do as a nation. We have the means of doing this. We have in our genes, that is, the wherewithal, but they have been allowed to atrophy.

Student: Of course, there's a completely opposite view in terms of the current account deficit, and that sort of thing, and that's that it doesn't matter. It really doesn't matter. It's not the government. There was an article in *The Wall Street Journal* which basically said the United States doesn't owe this \$176 billion.* I owe some of it, and Joe Blow over here owes some of it, and all of us together owe this, but it really doesn't matter. It can keep going on forever. What would be your argument against that? As long as the Japanese are willing to keep investing there's no sign of trouble.

Lodge: I suppose it's like Brazil. The banks can't pull the plug on Brazil, because they're so deeply in hock, so they've got to keep lending Brazil the money to pay the interest on the debt.

Student: They could never let us go that broke.

Lodge: Japan won't let us go bankrupt. I think the question is control — the title of this seminar. Where is control going? Who is deciding the future

of the United States? I'm saying it ain't us. It's our competitors. It's the people upon who we are now increasingly dependent. Not just for money; for microelectronics, for all kinds of things.

Oettinger: If one believes the notions about interdependence having to do with communications, and transportation, and everything, technology in space, and etc., etc., is that all bad? It's like arguing between Massachusetts and Texas at an earlier stage in the Union, or even not so recently when they had bumper stickers saying, "Let the bastards freeze in the dark." That was Texas, not Japan. The common denominator, whether you regard jobs being exported, or the welfare of the corporation manifesting itself by going by "exit" rather than by "loyalty," one way or another the common denominator in these things is a comparative, perhaps absolute, reduction in the standard of living in the United States, having to do with the fact that the post-World War II peculiarities are past, and being part of the whole world is a given. The argument is then in the details, and in the question of how one wants to adjust to that kind of reality. That's then the question of whether it's better on capital account or on some other. One way or another, the reality is a comparative or an absolute reduction in the standard of living.

Lodge: Quite so. One of the measures of deteriorating competitiveness is share of world markets, the share of world GNP today. Each is about half of what it was 30 years ago. You can say that's the way it ought to be. Thirty years ago it was outlandish. The Marshall Plan and everything else was designed to produce market shares for more nations.

Oettinger: We were enormously successful in what we undertook.

Lodge: Now the question is, how far down does this share go? And, who decides? That's the more important question. Who decides what share the United States gets? Us, or somebody else? I just think that if we mean what we say about independence, about our ability to have the way of life we want to have and all that, a certain amount of control is required. I don't mean absolute control. It's impossible because of interdependence. The thing that bothers me is that nobody seems to be thinking in these terms. President Reagan is saying "We're number one, we're number one, we're number one," when we're not. It's the foolishness that gets me, more than anything else. It's the unrealism. That's what gets me.

Oettinger: Thank you very, very much for an extraordinarily enlightening experience.

*Herbert Stein, "Leave the Trade Deficit Alone," *The Wall Street Journal*, New York, March 11, 1987.